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NOTES

CERTIFICATES OF INDEBTEDNESS IN OUR WAR FINANCING

A notable feature of the present war financing of the United States has been the large part played by negotiable short-term debt obligations under the designation of "certificates of indebtedness." In outright volume the gross amount of such certificates thus far issued (June 1, 1918) has been greater than the principal sum of any two of the Liberty Loans and will soon exceed all three combined. Emitted in short maturities, the actual amount of certificates at any time outstanding—now authorized to a maximum of $8,000,000,000—has with a single brief exception (July 30–August 9, 1917) been considerable since our first entry into the war, and since August, 1917, has never been less, at the close of any month, than $1,250,000,000, rising as high as $3,936,339,500 (April 30, 1918), with an amount actually outstanding on May 31, 1918, of $2,575,967,000.[1] The Treasury has made habitual use of such certificates to anticipate the yield of war loans and war taxes for national defense and Allies' credits and has prepared for continued reliance upon the same expedient. Finally, the certificates have been deemed capable of exerting important influence upon the money market and upon the price level, and the efforts of the Treasury, in harmony with the Federal Reserve Board, have been expended in guiding and shaping this influence to the general good. In another place[2] I have sought to analyze the direct fiscal results of the Treasury's policy in this connection as well as to trace its collateral effects upon the business world and upon social well-being. In the present connection it is proposed only to describe its external features.

From the preparatory measures taken before the actual declaration of hostilities up to the present time of writing the United States has

[1] Monthly "Financial Statement of the United States Government," formerly issued as "Statement of the Public Debt" (Division of Bookkeeping and Warrants, Treasury Department). No statements were issued for July, August, September, and October, 1917, and for these months the nominal aggregates of the outstanding issues have here been used.

[2] *War Borrowing: A Study of Treasury Certificates of Indebtedness of the United States*. In press.

emitted twenty-three formal issues of certificates of indebtedness, as shown in Table I.

TABLE I

Series*	Date of Issue	Interest Rate	Date of Maturity	Nominal Amount
[1]............	Mar. 31, 1917	2	June 29, 1917	$ 50,000,000
[2]............	April 25, 1917	3	June 30, 1917	268,205,000
[3]............	May 10, 1917	3	July 17, 1917	200,000,000
[4]............	May 25, 1917	3¼	July 30, 1917	200,000,000
[5]............	June 8, 1917	3¼	July 30, 1917	200,000,000
[6]............	Aug. 9, 1917	3½	Nov. 15, 1917	300,000,000
[7]............	Aug. 28, 1917	3½	Nov. 30, 1917	250,000,000
[8]............	Sept. 17, 1917	3½	Dec. 15, 1917	300,000,000
[9]............	Sept. 26, 1917	4	Dec. 15, 1917	400,000,000
[10]...........	Oct. 18, 1917	4	Nov. 22, 1917	385,197,000
[11]...........	Oct. 24, 1917	4	Dec. 15, 1917	685,296,000
[12]...........	Nov. 30, 1917	4	June 25, 1918	691,872,000
[13]...........	Jan. 2, 1918	4	June 25, 1918	491,822,500
[14]...........	Jan. 22, 1918	4	April 22, 1918	400,000,000
[15]...........	Feb. 8, 1918	4	May 9, 1918	500,000,000
[16]...........	Feb. 15, 1918	4	June 25, 1918	74,100,000
[17]...........	Feb. 27, 1918	4½	May 28, 1918	500,000,000
[18]...........	Mar. 15, 1918	4	June 25, 1918	110,962,000
[19]...........	Mar. 20, 1918	4½	June 18, 1918	543,032,500
[20]...........	April 10, 1918	4½	July 9, 1918	551,226,500
[21]...........	April 15, 1918	4	June 25, 1918	71,880,000
[22]...........	April 22, 1918	4½	July 18, 1918	517,826,500
[23]...........	May 15, 1918	4	June 25, 1918	183,767,000

*The bracketed numerals are used merely to distinguish the issues in the present study. As a matter of fact "only a few of the issues had serial letters and numbers printed on the certificates, the other issues being without any serial designation." The issues in anticipation of the Fourth Liberty Loan have been conveniently designated as Series IV and the successive issues distinguished by serial letters.

In fiscal purpose the twenty-three series may be arranged in five groups, as shown in Table II.

TABLE II

Series	In Anticipation of	Nominal Amount
(A) [1]..........................	1917 income tax	$ 50,000,000
(B) [2] [3] [4] [5]..................	First Liberty Loan	868,205,000
(C) [6] [7] [8] [9] [10] [11]..........	Second Liberty Loan	2,320,493,000
(D) [12] [13] [16] [18] [21] [23]......	1918 income and excess, profits taxes	1,624,403,500
(E) [14] [15] [17] [19] [20] [22]......	Third Liberty Loan	3,012,085,500

There have thus been emitted, in conjunction with our war financing, twenty-three issues of certificates of indebtedness to an aggregate amount of $7,875,187,000. Of these the initial issue was nominally in anticipation of the proceeds of the 1917 income tax and six subsequent issues

were in anticipation of the proceeds of the 1918 income and excess-profits taxes, the latter group, however, partaking of important characteristics of the loan-anticipation issues. The remaining sixteen issues, of an aggregate amount of $6,200,783,500, were emitted in anticipation, successively, of the proceeds of the First, Second, and Third Liberty Loans.

Such anticipatory borrowings have formed a large proportion of the nominal amounts of the Liberty Loans. The ratio of the nominal volume of certificates outstanding at the date upon which the first instalment on account of the loan was payable, to the amount of the loan has been approximately as shown in Table III.

TABLE III

Liberty Loan	Date of First Instalment	Amount of Loan	Certificates Outstanding	Ratio of Certificates to Loan
First..........	June 28, 1917	$2,000,000,000	$ 868,205,000	43.4
Second........	Nov. 15, 1917	3,808,766,150	2,320,493,000	60.9
Third.........	May 4, 1918	4,170,019,650	2,612,085,500	62.6

In other words the Liberty Loans have been to an increasing extent required to discharge short-term indebtedness contracted, in anticipation of the flotation, by certificate borrowing.

The certificates have been taken and held in the main by the financial institutions of the country—national banks, state banks, and trust companies. The Federal Reserve banks, with whom was placed the entire ante-bellum issue of March 31, 1917, subsequently withdrew from the rôle of direct investors and confined themselves to the functions of distribution and remittance, with only such temporary investment service as was made necessary by administrative convenience, by the insufficiency of the banks' subscriptions, and by the desirability of aiding wider distribution of certificates among the banks.

Of the certificates acquired by the banks much the largest quota has been for their own account, only a minor part being apparently taken in behalf of customers. This applies to the loan-anticipation certificates; with respect to the tax-anticipation issues the conditions have probably been somewhat different. No precise tabulations are available as to the several amounts of the loan-anticipation certificates taken and held by investors. It is possible, however, to form some opinion as to this from the condition of the national banks on the several "call" dates; from the condition of "member banks in leading cities" reporting weekly after December 7, 1917, to the Federal Reserve Board; and from the condition of member banks other than national banks on December 31, 1917,

reported to the Federal Reserve Board. A somewhat involved and necessarily free computation made by the present writer from such data, elsewhere set forth in detail,[1] leads to the highly tentative conclusions that of the certificate issues prior to January 1, 1918, the banks took for their own account slightly less than seven-eighths; and that of the issues thereafter emitted up to April 19, 1918—when large amounts of tax-anticipation certificates had been sold "over the counter" and when progress had been made in securing a wider distribution and absorption of the loan-anticipation issues—the banks took something more than three-fifths.

In the absorption of the certificates for themselves and their customers the banks of the New York district have taken the leading part, and this tendency has continued with the progress of the Treasury's short-term borrowing. Of the $868,205,000 certificates issued in anticipation of the First Liberty Loan, the banks of the New York district took $459,962,000, or 53 per cent; and of the $2,320,493,000, issued in anticipation of the Second Liberty Loan, $1,467,543,000, or 63 per cent, was so taken. Of the final issue of this series—$685,296,000 bearing date of October 24, 1917—the New York banks took no less than $543,683,000, or 79 per cent, and even of the next succeeding issue—the first of the series of tax-anticipation issues, $691,872,000, bearing date of November 30, 1917—no less than $494,070,000, or 71 per cent, was so taken.

With the systematic efforts of the Treasury to establish a wide subscription basis for the certificate issues in anticipation of the Third Liberty Loan, the relative amounts allotted to the New York district became less. Of the $3,012,085,500 so issued, only $1,255,308,000, or 42 per cent, was taken by New York. It is, however, significant that with the later issues of the series the New York quota again tended to rise, although to nothing like the former maximum. The relative distribution of the six issues of certificates in anticipation of the Third Liberty Loan among the financial institutions of the Federal Reserve districts is shown in Table IV.

Within the New York district the essential rôle was of course played by the New York City banks with respect to the issues in anticipation of the Second Liberty Loan: "Of the 1,076 banks (not including savings banks) outside of New York City, 308 purchased certificates of indebtedness, but of these only about one-half were what may be termed

[1] "Holdings by the Banks of Treasury Certificates," *Federal Reserve Bulletin* (September, 1918), H. 845–47.

regular purchasers. The others participated in only one or two of the issues."[1]

TABLE IV

	January 22	February 8	February 27	March 20	April 10	April 22
Treasury	....	0.6	0.7	0.7	....	0.3
Boston	5.0	5.8	7.1	9.8	7.2	7.0
New York	52.4	48.3	34.6	35.6	39.1	43.0
Philadelphia	5.6	5.0	6.6	6.9	6.8	6.7
Cleveland	6.5	6.8	8.9	8.9	8.3	7.5
Richmond	1.8	2.4	3.6	3.0	2.0	2.1
Atlanta	2.4	2.5	3.0	2.9	3.1	2.1
Chicago	7.6	8.5	11.8	11.8	11.9	12.2
St. Louis	4.5	4.0	5.1	4.2	3.8	4.9
Minneapolis	2.7	3.0	3.4	2.9	2.8	2.9
Kansas City	3.0	4.3	4.8	4.8	4.5	3.9
Dallas	3.3	2.8	3.8	2.7	3.0	2.5
San Francisco	5.3	5.0	6.7	5.7	7.1	4.5

To a small extent in the case of the certificates issued in anticipation of the First Liberty Loan and to a very considerable extent in the case of succeeding issues, payment for certificates was made by subscribing banks "by credit." Full data as to the relative importance of such credit payments are available to the writer only for the certificates taken by subscribing banks in the Federal Reserve District of Boston; but it is likely that the figures for the country at large are not notably different from those of this particular District.

The first phase of our war borrowing—the recurrent issue of loan-anticipation certificates of indebtedness—has thus resolved itself very largely into an extension to the Treasury of deposit credits, in the form of "government deposits," by and through financial institutions qualified as special depositaries. This tendency to create deposit currency as an incident of war borrowing rather than of business expansion has been further emphasized in the second phase of our funding policy—the periodic flotation of a Liberty Loan in anticipation of which the certificates of indebtedness were issued and the proceeds of which were designed to extinguish the certificates so issued on or before maturity. The simplest procedure, anticipated, it might be imagined, in the Treasury's program, would have been for the outstanding certificates to have been tendered by the banks in payment of the loan subscriptions, leaving the

[1] *Fourth Annual Report of the Federal Reserve Board*, p. 277. This relative non-participation of the banks outside of New York City underwent striking change with the systematic enlistment of the banking strength of the country in connection with the anticipatory borrowing of the Third and Fourth Liberty Loans. Thus of the 1,042 national banks, state banks, and trust companies in the New York Federal Reserve District, no less than 861 subscribed to the certificate issue of September 3, 1918.

banks upon the completion of the operation in possession of long-term bonds instead of short-term certificates. This, however, would in the opinion of the Treasury have defeated the ends desired—keeping the banking resources of the country in so far as possible liquid and securing the widest popular absorption of the bonds.

TABLE V

Issue of	Total Issued in Boston District*	Paid by Credit*	Percentage Paid by Credit
1917			
Mar. 29	$ 3,000	....	....
April 25	13,800	....	....
May 1	2,000	....	....
May 10	12,167	$ 5,450	.447
May 25	11,200	....	....
June 8	18,200	3,652	.200
Aug. 9	19,400	6,500	.335
Aug. 28	15,140	4,593	.303
Sept. 17	12,171	5,195	.426
Sept. 26	22,174	12,245	.552
Oct. 18	30,149	21,349	.708
Oct. 24	33,010	27,590	.835
Nov. 30	20,921	20,090	.960
1918			
Jan. 2	16,163	13,219	.817
Jan. 22	20,025	17,587	.878
Feb. 8	29,134	24,870	.853
Feb. 15	8,790	7,535	.857
Feb. 27	35,369	30,059	.849
Mar. 15	6,735	4,864	.722
Mar. 20	53,690	49,204	.917
April 10	39,731	36,084	.908
April 15	5,220	3,250	.622
April 22	36,468	27,143	.744

* 000 omitted.

The actual procedure was for each loan flotation to take the form of an intensive popular campaign in which bonds were subscribed by individuals, through banks, and by banks on their own behalf, such subscriptions being forwarded to the Treasury through the Federal Reserve banks as the fiscal agents of the Treasury. In due course allotments were made by the Treasury through the Federal Reserve banks to the subscribing banks for the amounts taken in their own behalf and for their clients. Individual subscribers made payment for bonds through their banks by drawing upon existing deposit accounts, by creating new loans and deposit credits and drawing directly or indirectly thereon, and by tendering cash items—withdrawn (unless taken from hoards) from circulation, from savings or from other banks, but coming ultimately from the liquid resources of the banks—cash in vault in the first instance,

Federal Reserve notes obtained by rediscount thereafter. In turn, subscribing banks made payment, overpayment, or payment in full through the Federal Reserve banks for bonds allotted to them for themselves and for their customers by tender of certificates, by credit, or by cash items. These three modes of payment figured in the heavily overpaid first instalments of the three Liberty Loans in the proportions shown in Table VI.

TABLE VI

	First	Second	Third
Part of loan paid on first instalment	73	73	77
Composition of first instalment payment:			
Certificates	38	17	26
Credit	27	53	47
Cash	35	30	27

A small use of cash and certificates and a heavy use of credit in payment of bond subscriptions thus marked the successive Liberty Loan flotations. As to cash, payments were made by interior banks by drafts upon the reserve banks, and by the reserve banks by drafts upon their reserve balances with Federal Reserve banks, this resulting in turn in a heavy demand for discounts from member banks and through them for non-member banks for the restoration of depleted reserves. As to credit, the banks followed the procedure elsewhere described, creating in the special depositaries new or additional government deposits to the amounts paid in this manner. Over and above the two restraints operative in the case of credit payments for certificates—extent of qualification as government depositaries and capacity of banking resources to meet subsequent withdrawals of government deposits—a third limitation figured in the restrictions imposed by the Treasury as to the relative amount permitted of such credit payment.

Both relative to the total subscription payments and, more significantly, with respect to the aggregate volume of certificates at the time outstanding, certificates of indebtedness were used to a notably minor extent in the banks' payments for bond subscriptions. In the flotation of the First Liberty Loan, 64 per cent of the nominal volume of outstanding certificates was employed in the payments made on the first instalment date; but in the Second Liberty Loan only 20 per cent was so tendered, and in the Third Liberty Loan some 32 per cent was used.

Reasonable allowance having been made for certificates held by subscribing banks in excess of their subscriptions, for certificates held

by individuals, corporations, and non-subscribing banks for investment purposes, and for certificates used in later instalment payments, it still appears true that in effecting settlement for Liberty Loan subscriptions the banks of the country elected to make large use of "payment by credit" and to retain a substantial part of their certificate holdings as

TABLE VII

Liberty Loan	Loan-Anticipation Certificates Outstanding	Certificates Used in First Instalment Payment	Percentage
First	$ 868,205,000	$554,500,000	64
Second	2,320,495,000	469,000,000	20
Third	2,612,085,500	823,332,600	32

short-term investments. Of direct fiscal importance, the collateral effects of such procedure in relation to the money market and the expansion of credit have been of even greater significance. But an analysis of these consequences lies beyond the scope of the present note.

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WASHINGTON NOTES

NEW FINANCIAL NEEDS

National financial requirements have again been increased by the presentation of a deficiency appropriation bill calling for more than $8,000,000,000 for the use of the army and navy. This added to the $24,000,000,000 already required by the previous program makes a total of some $32,000,000,000, provision for which must be made during the current fiscal year. Out of this amount about four and a half billion dollars has already been obtained from the banks through preliminary sales of certificates of indebtedness. That amount must be reimbursed through the use of an equivalent amount drawn from the proceeds of the Fourth Liberty Loan. The proceeds of this loan are therefore practically used up, or will be so, before the work of getting in the actual results of subscriptions has been completed. Assuming that the war revenue bill when adopted will yield as much as $9,000,000,000—a very high estimate of its return, unless a new program of taxation should be added to that which is now carried in the bill—it would be necessary to obtain from loans at least $23,000,000,000 to meet the new requirements, of which the proceeds of the Fourth Liberty Loan would furnish say between $6,000,000,000 and $7,000,000,000. Cer-